**SABAH FINANCE BHD.**

**v.**

**UMW (EAST MALAYSIA) SDN. BHD.**

HIGH COURT BORNEO, KOTA KINABALU
SYED AHMAD IDID JC
[CIVIL SUIT NO. K620 OF 1988]
12 DECEMBER 1990

***CONTRACT:*** *Lease of machinery - Guarantee and indemnity - Whether contributory negligence applicable - Principles of equity - Rights of surety - Contracts Act 1950, ss. 92, 94.*

***CONTRACT:*** *Lease agreement for machinery - Guarantor advised lessor that lessee intending to take machinery out of state - Inaction by lessor - Whether machineries were security to both lessor and guarantor - Equitable duty of lessor to guarantor - Terms of guarantee documents - Discharge of guarantor's liability - Definition of security - Contracts Act 1950, ss. 92 and 94 - Civil Law Act 1956, Pt v, s. 12(1).*

***LANDLORD AND TENANT:*** *Lease - Machineries - Guarantee - Property taken out of state - Inaction by lessor - Equitable duty of lessor towards guarantor.*

On 8 March 1985 the plaintiffs P a licensed finance company, entered into a lease agreement whereby they leased 2 pieces of machinery to the lessee L. The defendants, UMW, signed two "guarantee and indemnity" forms where they guaranteed the payment by the L and also indemnified P against all loss, damages, cost and expenses subject to the limit of 50% of such loss.

On 7 February 1986, UMW's solicitors notified P that L were making preparations to move the said machineries out of Sabah; On 15 February 1986, P's solicitors advised UMW's solicitors that they had advised L that L could not take the machineries out of Sabah without P's consent. UMW then notified P, on 7 March 1986, that the 2 units of machineries had been taken out of the state. By 12 July 1986, when L was 16 months in arrears, all P did was to notify L about the provision regarding sending of machinery out of Sabah. UMW alleged also that P did not attempt to inspect the machineries and that P failed to repossess the machinery when they had been put on notice.

UMW claimed that the machineries were security to both P and UMW and that P had failed in their duty towards UMW as they had not taken any positive steps to enforce the strict terms of the lease agreements against L and had thereby impaired the security and deprived UMW of their rights to the benefit of recourse to the security. In the circumstances UMW contended that they were discharged from their liability by ss. 92 and 94 of the Contracts Act; UMW also denied that they were liable to indemnify. P against the consequences of P or their agents negligence.

P contended that there was no obligation on their part to take any steps or actions in the event L fell into arrears. They claim that the equipment leased to L does not amount in law to a security. Further, that the terms of the guarantee document (AK1) authorised the lessor to allow any indulgence to the lessee and to waive any rights of the lessor whether bestowed on the lessor pursuant to any said agreement or by law and to vary the terms of the said agreement. In addition, AK1 also provided that the guarantors agreed that the lessor shall not be bound at any time to exercise any of its rights under the said agreement and any omission by the lessor so to do shall not affect or discharge the guarantor's liability.

P submitted that ss. 92 and 94 of the Act did not apply as UMW had also signed an indemnity.

The issue for the Court was whether P had an equitable duty to UMW as surety to preserve the security, if it is accepted that there are security interests in the goods.

The writ was issued and served on UMW on 9 January 1989 and on 19 April 1989, P filed proceedings under O. 14 r. 1 of Rules of the High Court 1980 for final judgment against UMW.

**Held:**

**[1]** (a) Section 92 of the Contracts Act, illustration (c) read together with Pt V, s. 12(1) of the Civil Law Act 1956, is applicable in this case as UMW, on 7 February 1986 took keen interest to safeguard their responsibility;

(b) P's reply on 15 February 1986 was a clear indication of the neglect by P to act in the interests of UMW;

(c) the goods, whether or not these were considered as security had been lost and the lessee had parted with them - a security is anything that makes the money more assured in its payment or more readily recoverable.

**[2]** P adopted a lackadaisical or couldn't-care-less attitude - the Court frowns upon such imprudence and non-performance of the parties' legal duties; in fact, P allowed L to be 16 months in arrears before any action was taken.

*[P's application refused.]*

**Cases referred to:**

*A.B. Marintrans v. Comet Shipping Co. Ltd. The Shinjitsu Maru No. 5 [1985] 3 All ER 422*
*Basildon District Council v. Je Lesser (Properties) Ltd. & Ors. [1985] 1 All ER 20*
*British Oil Mills Co. v. Inland Revenue Commissioners [1903] 1 KB 697*
*Buckeridge v. Mercantile Credits Ltd. [1981] 56 ALJR 28*
*Chatterton v. MacLean [1951] 1 All ER 761*
*China and South Sea Bank Ltd. v. Tan [1989] 3 All ER 839*
*Malayan Insurance (M) Sdn. Bhd. v. Asia Hotel Sdn. Bhd. [1987] CLJ (Rep) 182*

**Legislation referred to:**

Arbitration Act 1950 [UK], s. 21
Civil Law Act 1956, s. 12(1)
Contracts Act 1950, ss. 92, 94
Rules of the High Court 1980, O. 14 r. 1, O. 33 r. 2

**Other sources referred to:**

*Modern Contract of Guarantee* by James O'Donovan and John C Phillips
*"The Reform of the Law of Security Interests" in Current Legal Problems* 1989 Vol. 42 by Aubrey L. Diamond

*For the plaintiffs - Norbert Yapp; M/s. Jayasuriya Kah & Co.*
*For the defendants - Phillip Lee; M/s. Malanjum Lee & Aziz Co.*

**JUDGMENT**

**Syed Ahmad Idid JC:**

The plaintiffs claim:

(1) the sum of RM706,995.80;

(2) agreed interest at the rate of 15% per annum calculated from 24 August 1988 until full payment;

(3) such further or other reliefs as the Court may deem fit; and

(4) costs.

Plaintiffs applied under O. 14 r. 1 of the Rules of the High Court 1980 to enter final judgment against the defendants on the ground that the defendants have no defence to the claim.

The plaintiffs are a licensed finance company carrying on business at 84, Jalan Gaya, Kota Kinabalu, Sabah, and is also a lessor within the lease agreement (AK3).

The said sum of RM706,995.80 is 50% of the sum of RM1,413,991.61 which plaintiffs claim is payable to them by the lessee.

The lessee is Hiew Fook Realty (Holdings) Sdn. Bhd. The defendants signed two "guarantee and indemnity" forms on 8 March 1985 where they guaranteed the payment by the lessee to the plaintiffs and also indemnified the plaintiffs against all loss, damage, costs and expenses... subject to the limit of 50% of such loss, damage, costs and expenses suffered or incurred by the plaintiffs. The lessee went into receivership in or around December 1988.

On 8 March 1985 - Lease agreements were signed between Sabah Finance Bhd. (plaintiff/ lessor), and Hiew Fook Realty (Holdings) Sdn. Bhd. (lessee), whereby the lessor agreed to lease goods described as:

(i) Komatsu Crawler for a total lease rentals of RM776,592; and

(ii) Bomag BW212PD Vibrator Roller for a total lease rentals of RM201,024.

After adding residual value and overdue interest up to 23 August 1988 and deducting the rentals paid, the overdue sums on the goods were (i) RM1,123,241.49; and (ii) RM290,750.12, thus totalling RM1,413,991.61.

On the same date, by 2 separate "guarantee and indemnity" documents the defendants guaranteed the payment by the lessee to the plaintiffs of all sums of money due and payable under the terms of the said lease agreement and also indemnified the plaintiffs against all loss, damage, costs and expenses suffered or incurred by the plaintiffs by reason of a breach or non-performance by the lessee under the said lease agreements, subject however to the limit of only 50% of such loss, damage, costs and expenses suffered or incurred by the plaintiffs.

On 7 October 1988, the plaintiffs by a registered letter dated 7 October 1988 through their solicitors demanded payment of the sum of RM706,995.80 from the defendants but the defendants have failed and/or neglected to pay the said sum or any part thereof to the plaintiffs.

The writ was issued on 16 December 1988 and served on the defendants on 9 January 1989.

On 19 April 1989, M/s. Jayasuriya Kah & Co., filed a summons-in-chambers under O. 14 r. 1 of the Rules of the High Court 1980 applying for an order that the plaintiffs may be at liberty to enter final judgment against the defendant herein for the sum of RM706,995.80 together with agreed interest and costs on the ground that the said defendants had no defence to the claim in the suit. The affidavit-in-opposition by Johnny Cham, the accountant of UMW (East Malaysia) Sdn. Bhd., was sworn on 17 November 1989. In this he claimed to be duly authorised by "the plaintiffs". It was only on 8 October 1990 that his corrective affidavit amended this to "the defendants". Counsel should have been concerned with O. 41 r. 5.

The matter came to Court on 20 November 1989 when it was ordered that the application be heard in open Court on 6 July 1990. It was then adjourned to 11 November 1990 when the hearing of the application was commenced and completed.

The plaintiffs stated that the lessee, in breach of the lease agreements, had defaulted in the payment of the monthly lease rental since the month of April 1985. The plaintiffs also said that the lessee made only 1 payment (one month prepaid rental) at the time of entering into the lease agreements and made no other payment to the plaintiffs. Clause 21 of the said lease agreements provided that if the "lessee should make default in payment" of any of the instalments payable thereunder the lessee should pay to the plaintiffs interest on the sum or sums in arrears at the rate of 15% per annum. On that ground, it was claimed that the lessee was liable to pay the plaintiffs the total sum of RM1,413,991.61.

Plaintiffs contended that the defence showing that the plaintiffs had been negligent in not repossessing the equipment under lease when the lessee fell into arrears was not valid. The guarantors (or defendants) were not discharged from their liability. The guarantee documents "AK1" was clear when the guarantors at para. (b) authorised:

> the lessor to grant or allow any time or indulgence to the lessee and to make any composition with the lessee as the lessor may think fit and to waive any of the rights of the lessor whether bestowed on the lessor pursuant to any of the said agreement or by law and to vary any of the terms and conditions of the said agreement.

Further, the guarantors agreed:

> that the liability and obligation of the guarantor to the lessor hereunder shall be a continuing one and the lessor shall not be bound at any time to exercise any of its rights under the said agreement and any omission by the lessor so to do shall not affect or discharge the liability of the guarantor hereunder.

Can this be accepted? Are such clauses so wide that they gave licence to the lessor to refuse to perform their duties and still hold the lessee liable for such consequences? The defendants and the plaintiffs had acted as follows:

(i) On 7 February 1986 the defendants, through their solicitors, wrote and put the plaintiffs on notice that the lessee were making preparations to "move the said machineries away from Sabah". See "JC2".

(ii) On 15 February 1986 the plaintiffs, by their solicitors, replied to the defendants' solicitors and stated that the lease agreements with the lessee provided that the lessee shall not send or take the machineries outside Sabah without first obtaining the plaintiff's consent in writing. The plaintiffs further stated that they had accordingly brought to the attention of the lessee the said provision. See "JC3".

(iii) The plaintiffs took no other or further action to investigate or attempt to inspect the said machineries and were content to leave the said machineries in the hands of the lessee. See paras. 6 and 7 of the plaintiffs' affidavit-in-reply and "AK3" where, at Clause 28, it allows the lessor expenses for;

> obtaining possession of the goods ... (or ... to enable the lessor to obtain possession of the goods).

(iv) On 7 March 1986 the defendants, by their solicitors, notified the plaintiffs' solicitors that 2 units of the said machineries had been taken out of the state. See "JC4".

The defendant claimed that the machineries act as a security to both the plaintiffs and the defendants as guarantors in the event that the lessee defaults or is placed under receivership and is unable to meet its obligations under the lease agreements. The machineries were on recourse to the defendants on 50:50 basis:

(i) By neglecting to preserve the said machineries and not taking any or any positive steps to enforce the strict terms of the lease agreements against the lessee, the defendant claimed that the plaintiffs had failed in their duty towards the defendants and had thereby impaired the security and deprived the defendants of their rights to the benefit of recourse to the security.

(ii) In the circumstances the defendants said they are discharged from their liability under the guarantee to the plaintiffs. As for the "alleged" indemnity, the defendants denied they are liable to indemnify the plaintiffs against the consequence of the plaintiffs' or their agents' negligence.

This being a contract case, a similar ruling can be forthcoming as was held in the *China and South Sea Bank Ltd. v. Tan* [1989] 3 All ER 839 where it was held that:

> The tort of negligence had not supplanted the principles of equity nor did it contradict contractual promises or complement the remedy of judicial review or supplement statutory rights. Since the rights of a surety continued to depend on the principles of equity it followed that unless the security was surrendered, lost, rendered imperfect or altered in condition by reason of what had been done by the creditor the surety remained liable under his contract to pay the creditor if the debtor failed to do so, and the creditor was entitled to sue him instead of pursuing his claim against the debtor or selling the mortgaged securities.

Counsel for the plaintiffs commented that nowhere was there any obligation by the plaintiffs to take any steps or actions in the event the lessee fell into arrears. In any case, the defendants had expressly excluded them in the guarantee at paras. (b) and (d) referred to earlier. The guarantee documents, "AK1" and "AK2", para. (b), states that the guarantor "...waives any rights of the lessor". Defendants' Counsel considered this did not make sense. Plaintiffs' Counsel quickly explained that this meant "between lessor and lessee, that is, defendants had authorised lessor to waive whatever rights he had against the lessee." These documents are quite strange and badly worded.

Defendants cited instances to show negligence of plaintiff, for example:

(a) Plaintiffs failed to investigate into defendants' claim sufficiently - that is, machineries were about or likely to be removed from the State. "JC2".

(b) Plaintiffs did not attempt to carry out an inspection of machineries at the material time - they left it in lessee's lands. Clauses 4 and 6 of the lease agreement empower plaintiffs to see/check the items. They did not.

(c) Plaintiffs failed to repossess when they had the chance after they had been put on notice.

(d) Plaintiffs failed to see that payments by the lessee had been promptly made.

By 12 July 1986, lessee was 16 months in arrears. All the plaintiffs did was to write to the lessee, that is, brought to their attention the provision that the lessee shall not send or take the machineries outside Sabah. "JC3".

Plaintiffs claim that they did not hold any security. The equipment leased to the lessee does not amount in law to a security. On the other hand, the defendants informed the court that if they are permitted to go on to the main action, the defendants will put up 2 issues and accordingly canvassed as follows:

(1) The machineries in this case were tantamount to security for purpose of the relationship between plaintiffs as creditor and lessee as principal debtor and the defendants as surety/ guarantor:

(i) Residual value (see Clause 24 which allows this) was attached to the goods or machinery in question of (a) RM136,000; and (b) RM35,200. As each has a residual value, this proves the goods were a security.

(ii) The goods were on recourse to defendants;

The plaintiffs are of the view that by virtue of Clauses 3 and 9 of the lease agreement, the machinery and equipment belong to the plaintiffs themselves and so they cannot become security. By Clause 3 of "AK3", the lessee "shall have no right of property... but is merely a bailee."

The cases of *Chatterton v. Maclean* [1951] 1 All ER 761 and *Basildon District Council v. Je Lesser (Properties) Ltd. & Ors.* [1985] 1 All ER 20 were canvassed in support. It is noted that hire purchase is different from leasing. The latter case shows that the defence of negligence is not open to defendants in respect of claims for breach of contract. At p. 30, the Judge in that case found:

> the holding company are not able to rely on the defence of contributory negligence to the Council's claims for damages for breach of contract.

Case of *A.B. Marintrans v. Comet Shipping Co. Ltd. The Shinjitsu Maru* No. 5 [1985] 3 All ER 422 which was cited, was reported solely on the question whether the Law Reform (Contributory Negligence) Act 1945 applied in the circumstances of the case "as that matter went to the Court by way of a special case stated pursuant to s. 21 of the Arbitration Act 1950" (of England), the matter was for information only:

(2) Defendants would also show that the plaintiffs were negligent and had defaulted by not taking steps to prevent the goods from being taken away. Prudent men would have heeded the defendants' suggestion.

According to the defendants, they are discharged of their liability by ss. 92 and 94 of the Contracts Act which reads:

> 92. Discharge of surety by creditor's act or omission impairing surety's eventual remedy. If the creditor does any act which is inconsistent with the rights of the surety, or omits to do any act which his duty to the surety requires him to do, and the eventual remedy of the surety himself against the principal debtor is thereby impaired, the surety is discharged.
>
> 94. Surety's right to benefit of creditor's securities.
>
> A surety is entitled to the benefit of every security which the creditor has against the principal debtor at the time when the contract of suretyship is entered into, whether the surety knows of the existence of such security or not; and, if the creditor loses or, without the consent of the surety, parts with the security, the surety is discharged to the extent of the value of the security.

The plaintiffs had claimed they too had suffered as a result of the breach of contract committed by lessee and further they claimed that the defendants had agreed to make good. Section 92 or 94 of the Contracts Act dealt with guarantees whereas here the defendants had signed an indemnity as well. Sections 92 and 94 do not therefore apply.

Do plaintiffs have an equitable duty to defendants as surety to preserve the security (in case we accept that there are security interests in the goods)? In the *Modern Contract of Guarantee* by James O'Donovan and John C Phillips, Brennan J in *Buckeridge v. Mercantile Credits Ltd.* [1981] 56 ALJR 28 stated the principle in clear terms:

> In a case where the act of a creditor does not discharge a surety, but the creditor has nonetheless sacrificed or impaired a security, or by his neglect or default allowed it to be lost or diminished, the surety is entitled in equity to be credited with the deficiency in reduction of his liability.

Mr. Lee also quoted from the 45 AIR [1921] Bombay 164 where it was held:

> further that the sub-agent's surety who had given a letter of indemnity by which, *inter alia*, he 'expressly waived all or any of the rights as surety (legal, equitable, statutory or otherwise) which may at any time be inconsistent herewith and which he might be otherwise entitled to claim and enforce', was nevertheless freed from his liability from future transactions.

The loss by the plaintiffs was their own doing so said the defence. The lessee had since inception fallen into arrears. Here, the AIR [1980] Vol. 67 Supreme Court Section at p. 1533 states:

> 19. It is difficult to entertain a contention that s. 141 would not be attracted and the surety would not be discharged even if it is found that a creditor has taken more than one security on the basis of which advance was made and the surety gave personal guarantee on the good faith of other security being offered by the principal debtor which itself may be a consideration for the surety offering his personal guarantee and the creditor by its own negligence lost one of the securities.
>
> Acceptance of such a contention would be tantamount to putting a premium on the negligence of the creditor to the detriment of the surety who is usually described as a preferred debtor. Should a Court by its construction of such letter of guarantee enable the creditor to act negligently and yet be not in any manner accountable? Was the guarantee a guarantee against proper performance of the contract evidencing advance of loan and methods of its repayment, or a guarantee covering the bank's utter disregard of its responsibility or to use the words of the High Court, the bank's utter negligence in failing to exercise the care of a prudent man which one would expect in management of one's own affairs?

On the question of O. 14, defendants' Counsel drew the Court's attention to *Malayan Insurance (M) Sdn. Bhd. v. Asia Hotel Sdn. Bhd.* [1987] CLJ (Rep) 182 where the Supreme Court held that:

> (2) The Court hearing an O. 14 application should work within the framework of O. 14 and not under O. 33 r. 2.
>
> (3) Where the issue raised is solely a question of pure law and simple undisputed facts the Court should exercise its duty under O. 14 and decide on the question of law. This is so even if the issue of law raised is a difficult one. If the Court, after considering the argument, is satisfied that it is really unarguable then the Court should grant summary judgment.
>
> (4) The underlying philosophy in the O. 14 provision is to prevent a plaintiff clearly entitled to the money from being delayed in his judgment where there is no fairly arguable defence to the claim. The provision should only be applied to cases where there is no reasonable doubt that the plaintiff is entitled to judgment.

Counsel urged the Court to dismiss the application with costs. Plaintiff then quickly reminded the defendants that even if plaintiffs had been negligent, that still would not discharge the guarantors themselves. Plaintiffs did all that was required of them. There was no evidence that the goods had been taken out of Sabah. In fact it was incumbent on the defendants to take action to prevent the goods being taken away to protect defendants' own interest.

A. Whether or not contributory negligence can apply in Malaysia, Part V, s. 12(1) of the Civil Law Act 1956 (Revised 1972) throws some light:

> 12(1) Where any person suffers damage as the result partly of his own fault and partly of the fault of any other person or persons, a claim in respect of that damage shall not be defeated by reason of the fault of the person suffering the damage, but the damages recoverable in respect thereof shall be reduced to such extent as the Court thinks just and equitable having regard to the claimant's share in the responsibility for the damage:
>
> Provided that:
>
> (a) this subsection shall not operate to defeat any defence arising under a contract; and
>
> ("Fault" means negligence ... or omission).

B. Section 92 of the Contracts Act at Illustration (c) is applicable in that here we have the defendant, on 7 February 1986, taking keen interest to safeguard their responsibility. Defendants through their solicitors had written to plaintiffs as follows: (see "JC2").

> The Manager
> Sabah Finance Berhad
> Kota Kinabalu
>
> 7 February 1986
>
> Dear Sir,
>
> **Re: Recourse Finance**
> **Hiew Fook Realty (Holdings) Sdn. Bhd.**
>
> We act for UMW (East Malaysia) Sdn. Bhd.
>
> We have been briefed by our clients that you are the financier of ten units of machineries on a recourse basis to our clients. The machineries are as follows:

| Chassis No. | Engine No. | Model |
|---|---|---|
| 25488 | 41402 | D155AR-1 |
| 10143 | 26187662 | W180-1 |
| 10542 | 26181370 | PC300-1 c/w NPK Breaker |
| 100227 | 6572324 | BW212 |
| 100240 | 6573328 | BW212D |
| 100157 | 6566536 | BW212D |
| 79593 | 6271424 | BW212 |
| 12721 | 15134 | D75S-5 |
| 12720 | 15135 | D75S-5 |
| 11951 | 15148 | D75S-5 |

> The said machineries were leased to Hiew Fook Realty (Holdings) Sdn. Bhd.
>
> Our clients have been verily informed and in fact they have very strong reasons to believe that the said lessee, Hiew Fook Realty (Holdings) Sdn., are intending to move the said machineries away from Sabah. You are well aware that once the machineries are out of Sabah there is no longer a chance to repossess the same.
>
> We have therefore been instructed to notify you of this strong likelihood aforementioned and to urge you to consider and take all appropriate steps in the circumstances.
>
> Take notice that in the event of the said machineries being moved out of Sabah with you having taken no or inadequate steps to prevent the same despite this letter, our clients hereby notify you that they will not be obliged to comply with the recourse arrangement and that you are deemed to have assumed the full responsibility of the said machineries.

Kindly be informed and notified.

Thank you.

Yours faithfully,

(sgd)
cc: UMW Corporation Berhad
Shah Alam

cc: Clients

C. The reply, from M/s. Jayasuriya Kah & Co., to M/s. Richard Malanjum & Co., dated 15 February 1986 was terse:

> We act for Sabah Finance Bhd. and refer to your letter dated 7 February 1986 to our clients.
>
> The lease agreement which our clients had entered into with Hiew Fook Realty (Holdings) Sdn. Bhd. provides that the lessee shall not send or take the machineries outside Sabah without first obtaining our clients' consent in writing. Our clients have accordingly brought to the attention of the abovenamed lessee the above provision.

D. This was a clear indication of the neglect by plaintiffs to act in the interest of the defendants. Can we allow such irresponsible inaction? Is such refusal or neglect to act a good business etiquette? The answer is that the goods, whether or not these are considered as security, had been lost and the lessee had parted with them.

E. "A security interest is a right in property, or against property, that can be exercised to secure payment of a debt" (Aubrey L. Diamond - "*The Reform of the Law of Security Interests*" in Current Legal Problems 1989 Vol. 42). "By `to secure payment'" the writer went on to explain that he meant:

> to force the debtor to pay or to protect the creditor in some other way against the consequences of default.

A "security", speaking generally:

> is anything that makes the money more assured in its payment or more readily recoverable...

per Stirling LJ in *British Oil Mills Co. v. Inland Revenue Commissioners* [1903] 1 KB 697.

F. The plaintiffs adopted a lackadaisical or couldn't-care-less attitude. This court frowns upon such imprudence and non-performance of the parties' legal duties. The plaintiffs allowed the lessee to be 16 months in arrears.

On all the evidence, facts and law, there is no choice but to refuse to grant the order that the plaintiffs applied for under O. 14 r. 1.

Also found at [1991] 2 CLJ 1013